7.0 The Future of Countertrade

There are different views on the future of countertrade. The future of countertrade may be analyzed from two perspectives (OECD, 1985), short term and long term; and with regards to whether countertrade is a viable solution in response to the international trading system weakness.

Voluntarily participating in countertrade arrangements for individual firms may be a second-best solution in a condition characterized by the existence of market imperfections and distortions such as overvalued currencies and foreign exchange problems, where private firms were forced to operate within the constraints of a given market and enter into countertrade arrangement in order to bypass such restrictions. The trade generated under such circumstances may be view as a way that is 'better-than-no-trade', and will improve the domestic economic well-being.

Conducting countertrade transactions under conditions of instability in financial markets may be the least costly way of hedging against instability. The risks circumventing a potential trade transaction as concerns the price and the quantity of foreign exchange which may or may not be made available can be reduced through a countertrade agreement. The agreement can ensure that both parties must provide and receive goods according to specified conditions in the contract. Besides, countertrade can also allow firms to continue trading in situations where the economic policies in force may be such that rigid requirements to conserve or ration foreign currency holdings would have otherwise blocked the possibilities of sales. For example, Russian enterprises must return half of their hard-currency earnings from export sales to the Russian central bank, which is called the 50-percent rule. However, barter is permitted without central intervention from Moscow (Fluck, Adamski & Skehan, 1994). Countertrade transactions also allow the firm to hide price discounts which is vital for developing countries that sell petroleum and other commodities that are under the obligation of the international price control.

Even though countertrade transactions may be a practical solution to continue trading in specific circumstances, their inherent inefficiency and disadvantages will become apparent if these procedures become generalized (OECD, 1985). The complexities in matching the needs of sellers and buyers for totally unrelated products results on the increased transaction costs which resulted from the search involved in matching buyer, seller and products as well as time and effort spent on the negotiation process. Besides, increased cost will also result from the inability to choose the cheapest seller, as the arrangement was tied up and bundled together. Hence, countertrade transactions will only provide benefit in individual transactions but if carried out on a large scale, it can result in welfare reducing for the country as a whole.

Countertrade may be an effective means in preserving foreign exchange for developing countries in times of macroeconomic difficulties. Countertrade transactions may be seen in this context denoting continuation of sales without worsening the balance of trade and hence, may overcome foreign exchange shortages. However, from the point of view of a country as a whole, countertrade is not a rational economic choice, especially in a longer term perspective (OECD, 1985). This is due to that engaging in countertrade transactions is a way for governments to postpone taking action with regard to existing economic distortions. In fact, governments should act to correct the distortions which give rise to countertrade transactions.

Countertrade transactions show less apparent advantages for the advocate in the long term. In the long term, increased countertrade transactions in terms of commodities might disrupt existing trade patterns in the particular markets as well as may push producers to non-compliance with output quotas (OECD, 1985). Besides, leaving marketing of manufactures products to the trading partners will leave developing countries unable to developed crucial marketing and distribution strategy in the long term. There are also believes that goods produced for countertrade transactions are either surplus or are with under-performed quality. Even though these goods can be shifted to developed countries via countertrade, however these goods may eventually end up in other developing countries due to the difficulties in selling to consumers in developed countries. Therefore, long terms trading via countertrade may add additional costs to the consumers in the developing countries.

The future of countertrade turns on several factors, including the motivation of Western firms to countertrade and further developments in

Eastern and Central Europe (Neale, Akins & Pass, 1997). The breakdown in investors' confidence induced by the 1997 Asia financial crisis and its spillover effects on the other developing and developed countries have impaired, at least in the near term, private capital flows to emerging markets. As external capital will favor transactions that earn hard currency and are collateralized or enhanced by special security structures, hence the prospects for future growth of countertrade are controversial and would be crucially affected by macroeconomic developments on demand in world markets and availability of foreign exchange to third world countries. Besides, they would also be influenced by the perceptions of its costs and benefits as well as the experience of parties involved in countertrade such as governments, exporters and intermediaries.

Through most of the 1990s, contracts represented the main legal mechanism, even in high risk markets, for liquidating debt in case of performance default in countertrade arrangements. As a short term default financing options, countertrade arrangements and offset-related investments could, within appropriate creative financing structures, contribute to minimizing hard currency exposures, serve as risk mitigation vehicles, secure repayments and, possibly, provide credit enhancement of infrastructure projects.

There were grounds for expecting demands for countertrade to decline. This will happen if developing countries economic undergo steep reform to promote more efficient business transaction to avoid the possibility of slow and cumbersome countertrade negotiations. Domestic financial and banking development and injections of Western aid should ease highly indebted and currency shortages of developing countries. If this view is true, then countertrade activities may be in the decline in the years ahead. However, this view may be a little idealistic.

Although there are alteration to the economy and financial aspect of some developing countries, however the underlying reasons and motivations (the fundamental weakness of the current trading system) to use countertrade still remains. Countertrade growth has always been related to balance-of-payments difficulties that led developing countries to seek alternative financing techniques for trade and servicing of external debt. Currency, credit and resources will continue to be in short supply for many years to come and hence, the role of countertrade as a facilitator to the conventional 'money' trading could not be ignored (Egan & Shipley, 1996). If currency and credit problems persist in the future, countertrade may remain as a highly effective and possibly the only trading medium. As Neale et. Al, (1997) put it, countertrade may remain if currency and credit problems persist. "Normal' trade requires currency convertibility or reliable access to trade finance. Until these are universally established, countertrade activities are likely to feature in trading internationally.

The structural problems and imbalances that many developing countries are facing due to the inequality generated by the current trading system, reflect the scarcity of convertible currencies; adding to the fact that there are increasing third parties expertise such as consultancy and banking, may be the reasons to the continuation of countertrade activities despite its highly inefficient nature (OECD, 1985).